

Case Study – Financial Risk Assessment

Community College XYZ

Overview

This case study describes the flow of a Top-Down, Risk-Based Approach for example Agency ABC. Within this case study, we have example of the following type of internal control weakness:

Internal Control Weakness in a Test (page 12)

This case study is not all-inclusive and is to be used for informational purposes only.

Case Study – Financial Risk Assessment

Agency ABC

Financial Statements

FY 2011 – Consolidated Governmental Fund

Balance Sheet

Account Caption	Amount
<u>Assets</u>	
Cash and Cash Equivalents	8,671
Pooled Cash	207,624
Accounts Receivable	41,042
Intergovernmental Receivables	278,407
Interest Receivable	54,683
Due from Other Funds	112,954
Inventories	33,655
Notes Receivable	49,511
Amount available to be provided	36,061
Total Assets	822,608
<u>Liabilities</u>	
Accounts Payable	101,889
Accrued Payroll	31,776
Intergovernmental Payables	225,614
Due to Other Funds	54,419
Deferred Revenue	23,293
Funds Held for Others	7,902
Accrued Vacation Leave	36,061
Total Liabilities	480,954

Operating Statement

Account Caption	Amount
<u>Revenues</u>	
Federal Funds	6,362,327
Sales & Services	986,546
Fees, Licenses and Fines	1,298,598
Total Revenues	8,647,471
<u>Expenditures</u>	
Personal Services	16,509,976
Employee Benefits	4,416,224
Contracted Personal Services	632,815
Supplies and Materials	116,068
Travel	273,920
Communication	163,418
Utilities	15,437
Data Processing Services	210,670
Other Fixed Charges	78,583
Capital Outlay	1,692,142
Grants, State Aid and Subsidies	6,359,254
Insurance and Bonding	127,862
Reimbursements	-96,143
Total Expenditures	30,500,226

Case Study – Financial Risk Assessment

Agency ABC

Materiality & Account Risk

Consolidated Governmental Fund

Legend	
	Auto Calculating Field
	User Entry Field
	Copy from DSS

Materiality Threshold	
1%	Low=1
1% - 5%	Moderate=2
5%	High=3

Prepared by:	T. Smith
Reviewed by:	J. Doe

Materiality				Account Risk Assessment							
Account Caption	Account Balance	Materiality Percentage per Materiality Guidance		Materiality	Size and Composition	Transaction Volume	Transaction Complexity	Subjectivity / Estimation	Inherent Risk	Total Score	Stop or Continue to Process Risk
<div><div>Balance Sheet Assets</div><div><div>Use FY 2011 Financial Statements</div><div>% Total Assets & Other Debits</div><div>(Proprietary only) % Total Assets less Total Capital Assets</div></div></div>											
Cash and cash equivalents	8,671	1.05%		Moderate	2	1	1	1	2	7	Stop
Pooled cash	207,624	25.24%		High	3	3	1	1	3	11	Continue
Accounts receivable	41,042	4.99%		Moderate	2	1	1	2	2	8	Stop
Intergovernmental receivables	278,407	33.84%		High	3	1	1	1	2	8	Stop
Interest receivable	54,683	6.65%		High	3	1	1	1	1	7	Stop
Due from other funds	112,954	13.73%		High	3	1	1	1	1	7	Stop
Inventories	33,655	4.09%		Moderate	2	1	1	1	2	7	Stop
Notes receivable	49,511	6.02%		High	3	1	1	1	1	7	Stop
Amount available and to be provided	36,061	4.38%		Moderate	2	1	1	2	2	8	Stop
Liabilities											
Accounts payable	101,889	12.39%		High	3	2	2	2	2	11	Continue
Accrued payroll	31,776	3.86%		Moderate	2	2	1	2	1	8	Stop
Intergovernmental payables	225,614	27.43%		High	3	1	1	2	1	8	Stop
Due to other funds	54,419	6.62%		High	3	1	1	1	1	7	Stop
Deferred revenue	23,293	2.83%		Moderate	2	1	1	3	1	8	Stop
Funds held for others	7,902	0.96%		Low	1	1	2	1	2	7	Stop
Accrued vacation leave	36,061	4.38%		Moderate	2	2	1	2	1	8	Stop

To rate each account caption above, enter a 1 for Low, 2 for Moderate or 3 for High. High and Moderate risk accounts will move forward to the Process Risk Assessment.

Note: Agencies should rate criteria for all asset, liability, revenue and expenditure accounts. Risk ratings will vary by agency. Numbers above are for example purposes only.

Low	Total Score of 8 or less.
Moderate	Total Score of less than 12 but greater than 8.
High	Total Score of 12 or greater.

Case Study – Financial Risk Assessment

Agency ABC

Materiality & Account Risk

Consolidated Governmental Fund (continued)

Legend	
	Auto Calculating Field
	User Entry Field
	Copy from DSS

Materiality Threshold	
1%	Low=1
1% - 5%	Moderate=2
5%	High=3

Prepared by:	T. Smith
Reviewed by:	J. Doe

Materiality				Account Risk Assessment								
Account Caption	Account Balance	Materiality Percentage per Materiality Guidance		Materiality	Size and Composition	Transaction Volume	Transaction Complexity	Subjectivity / Estimation	Inherent Risk	Total Score	Stop or Continue to Process Risk	
Operating Statement Revenues	Use FY 2011 Financial Statements	% Total Revenues	% Total Expenditures									
	Federal funds	6,362,327	73.57%	20.86%	High	3	3	2	1	2	11	Continue
	Sales and services	986,546	11.41%	3.23%	Moderate	2	3	1	1	1	8	Stop
	Fees, licenses and fines	1,298,598	15.02%	4.26%	Moderate	2	3	1	1	1	8	Stop
Expenditures												
Personal services	16,509,976	190.92%	54.13%	High	3	3	2	1	3	12	Continue	
Employee benefits	4,416,224	51.07%	14.48%	High	3	3	2	1	3	12	Continue	
Contracted personal services	632,815	7.32%	2.07%	Moderate	2	2	1	1	1	7	Stop	
Supplies and materials	116,068	1.34%	0.38%	Low	1	1	2	2	2	8	Stop	
Travel	273,920	3.17%	0.90%	Low	1	2	1	1	3	8	Stop	
Communication	163,418	1.89%	0.54%	Low	1	1	1	1	1	5	Stop	
Utilities	15,437	0.18%	0.05%	Low	1	1	1	1	1	5	Stop	
Data processing services	210,670	2.44%	0.69%	Low	1	1	1	1	1	5	Stop	
Other fixed charges	78,583	0.91%	0.26%	Low	1	1	1	1	1	5	Stop	
Capital outlay	1,692,142	19.57%	5.55%	High	3	1	1	1	1	7	Stop	
Grants, state aid and subsidies	6,359,254	73.54%	20.85%	High	3	2	1	1	1	8	Stop	
Insurance and bonding	127,862	1.48%	0.42%	Low	1	1	1	1	1	5	Stop	
Reimbursements	-96,143	-1.11%	-0.32%	Low	1	1	1	1	1	5	Stop	

To rate each account caption above, enter a 1 for Low, 2 for Moderate or 3 for High. High and Moderate risk accounts will move forward to the Process Risk Assessment.

Note: Agencies should rate criteria for all asset, liability, revenue and expenditure accounts. Risk ratings will vary by agency. Numbers above are for example purposes only.

Low	Total Score of 8 or less.
Moderate	Total Score of less than 12 but greater than 8.
High	Total Score of 12 or greater.

Case Study – Financial Risk Assessment

Agency ABC

Process Risk

Legend	
	Auto Calculating Field
	User Entry Field
	Copy from Account Risk

Prepared by:	T. Smith
Reviewed by:	J. Doe

Account Caption	Account Risk Rating (High or Moderate)	Significant Processes	Size and Composition	Susceptibility Due to Error / Fraud	Complexity of Transactions	Similarity of Transactions	IT Dependency / Manual Intervention	Degree of Subjectivity / Estimation	Total Score	Stop or Continue to Location Risk or Narrative <i>At least one process must be documented for each account.</i>
Accounts Payable* (13th month accruals)	Moderate	Determine flagged AP amount	3	1	1	1	2	1	9	Stop
		Determine manual AP amount	1	2	2	1	3	2	11	Continue
		Post to G/L	3	1	1	1	1	1	8	Stop
* Set up new vendor masterfile, receive invoices and process payments should be included in expenditure account processes.										
Personal Services / Employee Benefits*	High	Set up new hire masterfile or make changes to masterfile	2	3	2	2	3	1	13	Continue
		Time entry and approval	3	3	1	1	2	1	11	Continue
		Process payroll	3	2	2	1	1	1	10	Stop
		Post to G/L	3	1	1	1	1	1	8	Stop
		Employee terminations	1	3	1	1	2	1	9	Stop
* Combined Personal Services and Employee Benefits because accounts are related and share the same processes.										

Low	Total Score of 10 or less.
Moderate	Total Score less than 15 but greater than 10.
High	Total Score of 15 or greater.

To rate each process above enter a 1 for Low, 2 for Moderate or 3 for High. The Process Risk Assessment should be completed for all account captions with a total score of High or Moderate on the Account Risk Assessment.

Note: Pooled Cash and Federal Funds were intentionally omitted above for example purposes. See the Community College Financial Case Study for an example of the Cash Process and Location Risk Assessment. Processes and risk ratings will vary by agency.

Case Study – Financial Risk Assessment

Agency ABC

Narrative

Fund(s): Consolidated Governmental

Account(s): Accounts Payable

Significant Process: Determine manual AP accrual amount

Significant Process Risk Rating: Moderate

Supporting System(s) / Application(s): NCAS AP Module

This document provides a description of the above Significant Process as of FYE 6/30/2012. Internal controls are *Italicized*, Critical Controls are **Bolded** and control weaknesses are underlined.

Input: Invoices received / approved August 1 - 15

Output: Manual AP journal entry voucher

July 31 is the cutoff for the flagged accrual process. The manual accrual amount is determined for the period August 1 – 15.

Invoices received or not approved for payment until August are reviewed by the Accountant III to determine if they were for services performed or goods received prior to June 30. The Accountant III makes copies of the paid invoices that need to be manually accrued and prepares an Excel spreadsheet listing the vendor, invoice number and invoice amount. *To ensure that the spreadsheet is accurate, the Accountant III prepares a calculator tape of all invoice copies and verifies that it agrees to the spreadsheet. (MAP1) To ensure that all necessary accruals have been identified, the Accountant III then prints an NCAS report of all expenditures for the period August 1 – 15 and reviews the report to determine if additional expenditures should be accrued. (MAP2)*

The manual accrual amount is recorded on a journal entry voucher with a June 30 effective date. **The JE voucher, spreadsheet, NCAS report and all supporting documents are given to the Controller who reviews the documentation and approves the voucher. (MAP3)**

Source(s): Policies and Procedures Manual – Accounts Payable; Accountant III

Prepared by: T. Smith

Interview Date: 04/12/2012

See the Community College Financial Case Study for an example of how to document an issue noted while writing the narrative.

Case Study – Financial Risk Assessment

Agency ABC

Narrative (continued)

Note: Label all your controls with a control reference number in the above narrative. This control reference number will be cross-referenced throughout the remainder of the templates.

A critical control is a control that will prevent or detect an error in the event that all other controls fail. If there isn't a critical control in the process you may need to test all the controls in your narrative. If the critical control encompasses the prior controls you will only need to test the critical control and not the individual control.

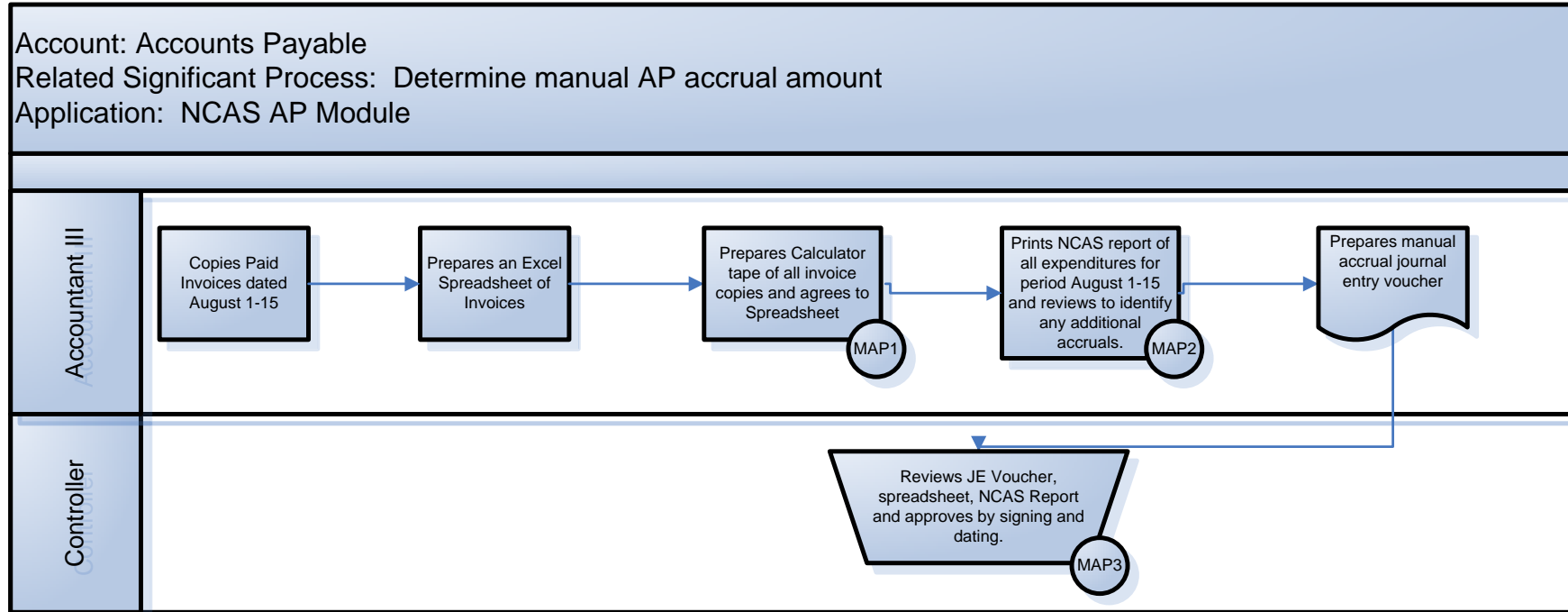
Refer to the Guidance Manual and/or Case Studies for an example of how to complete the narrative template. The narrative should be for the process in place at the end of the current fiscal year. If your Agency's processes are changing during the fiscal year, document the new process that will be in effect at the end of the current fiscal year, rather than the old process.

Narratives for Federal Funds-Determine amount to draw down; Personal Services/Employee Benefits-Set up new hire masterfile or make changes to masterfile; and Personal Services/Employee Benefits-Time entry and approval will also need to be completed. These were intentionally omitted from the case study.

Case Study – Financial Risk Assessment

Agency ABC

Flowchart (using swimlanes)



Accountant III reconciles all invoices to excel spreadsheet.



Accountant III prints and reviews NCAS report for any additional accruals.



Accountant III forwards the JE Voucher, spreadsheet, NCAS Report and all supporting documents to Controller who reviews the documentation and approves by signing and dating.

Note: A flowchart can be completed instead of, or in addition to, the narrative.

Case Study – Financial Risk Assessment

Agency ABC Walkthrough

Fund(s): Consolidated Governmental

Account(s): Accounts Payable

Significant Process: Determine manual AP accrual amount

Significant Process Risk Rating: Moderate

Supporting System(s) / Application(s): NCAS – AP module

This walkthrough assists in documenting our understanding of the design of controls. We are documenting the procedures performed, evidence obtained and conclusions as to the effective design of the underlying controls and whether the controls have been implemented. We will select a transaction that has occurred within the current Fiscal Year and walk through all controls listed on the narrative template (template 02).

Walkthroughs should be performed by someone who is not ordinarily involved in the process, and if possible, should be performed when the process occurs. A walkthrough should be performed for all controls identified in the narrative, both critical and non-critical.

Control Owner's Title: Controller

Date of Walkthrough/Interview: 04/19/2012

Walkthrough Performed by: T. Smith

Control Description and Control Reference #: The JE voucher, spreadsheet, NCAS report and all supporting documents are given to the Controller who reviews the documentation and approves the voucher. (MAP3) *Note: Remaining controls intentionally omitted for example purposes.*

Transaction Selection: JE voucher number #####

Procedures to Perform: We will review JE voucher ##### to verify that the voucher total agreed to supporting documentation and the voucher was approved by the Controller.

Results: We verified that the voucher agreed to the Excel spreadsheet and calculator tape. We also noted that the Accountant III's signature on the 'Prepared by' line and the Controller's signature on the 'Approved by' line. Notes and tickmarks were written on the NCAS report, indicating the report was reviewed. (See w/p MAP.1 for copies of supporting documentation.)

Conclusion: The control was in place and operating effectively at the time of the walkthrough.

Note: This walkthrough will assist you when the test of controls is performed. During the walkthrough, if a control does not appear to be in place for the item selected, look at a few additional items to determine if the error noted for the first item was an isolated incident. If the issue is recurring, it is not necessary to document a test plan and perform testing. The issue should be added to the Issue Summary Log. See the Community College Financial Case Study for an example of how to document an issued noted while performing the walkthrough.

Refer to the Guidance Manual and/or Case Studies for an example of how to complete the walkthrough template.

Case Study – Financial Risk Assessment

Agency ABC

Risk and Control Matrix (RACM)

Document:	Risk and Control Matrix (RACM)
Entity:	Agency ABC
Reporting Date:	June 30, 2012
Fund:	Consolidated Governmental
Financial Statement Account(s):	Accounts Payable
System(s) / Application(s):	NCAS - AP Module

Prepared by:	T. Smith
Reviewed by:	J. Doe

Significant Process	Process Risk Rating	Financial Statement Assertions	Risks	Control Owner	Control Description	Control Ref. #	Automated, Manual or Both?	Prevent or Detect?	Frequency of Control Activity
Determine manual AP accrual amount	Moderate	Completeness; Existence; Valuation; Rights & Obligations	Invoices are not properly accrued resulting in the understatement of liabilities.	Controller	The JE voucher, spreadsheet, NCAS report and all supporting documents are given to the Controller who reviews the documentation and approves the voucher.	MAP3	Manual	Prevent	Annually

Case Study – Financial Risk Assessment

Agency ABC

Test Plan

Document:	Test Plan
Entity:	Agency ABC
Reporting Date:	June 30, 2012
Fund:	Consolidated Governmental
Financial Statement Account(s):	Accounts Payable

Prepared by:	T. Smith
Reviewed by:	J. Doe

						Complete after testing			
Significant Process	Process Risk Rating	Control Description	Control Ref. #	Objective of Test	Test Procedures*	Results	Conclusion	Issue Raised?	Testing W/P Ref.
Determine manual AP accrual amount	Moderate	The JE voucher, spreadsheet, NCAS report and all supporting documents are given to the Controller who reviews the documentation and approves the voucher.	MAP3	To determine if the manual AP accrual is complete.	Review a sample of invoices paid August 1-15, 2011 to determine if the activity occurred prior to June 30, 2011. If yes, compare the invoice to the manual accrual documentation to determine if the amount was properly included.	Errors noted	Control is ineffective	Yes	MAP Leadsheet
							<Select Answer>	<Select Answer>	
							<Select Answer>	<Select Answer>	

*In this example, July expenditures would be tested in the Determine flagged AP accrual amount process. The FY 2011 (prior year) transaction is being tested because the FY 2012 (current year) transaction will not occur until after the July 31, 2012 certification deadline.

Case Study – Financial Risk Assessment

Agency ABC Test Leadsheet

Document:	MAP Leadsheet	Performed by:	T. Smith
Entity:	Agency ABC	Reviewed by:	J. Doe
Reporting Date:	June 30, 2012		
Fund:	Consolidated Governmental		
Financial Statement Account(s):	Accounts Payable		

Significant Process:	Determine manual AP accrual amount
Process Risk Rating:	Moderate
Control Reference #:	MAP3

Control Description:	The JE voucher, spreadsheet, NCAS reports and all supporting documents are given to the Controller who reviews the documentation and approves the voucher.
Control Frequency:	Annually
Automated, Manual or Both:	Manual
Prevent or Detect:	Prevent
Control Owner:	Controller
Estimated Population:	120 - All Aug 1-15 invoices
Sample Selection Methodology:	Random
Sample Size:	20

Source Test Documents:	Invoices paid August 1-15 and supporting documents
Test Procedures:	Review a sample of invoices paid August 1-15, 2011 to determine if the activity occurred prior to June 30, 2011. If yes, compare the invoice to the manual accrual documentation to determine if the amount was properly included.
Definition of an Exception:	Invoice amount for services performed or goods received prior to June 30 was not accrued.

Testing Section:	Customize column headings as necessary				Attributes
Sample No.	Invoice No.	G/L Effective Date	Service Date	Prior to June 30?	A
1	1122558	8/3/2011	7/20	No	
2	4515774	8/3/2011	6/25	Yes	✓
3	2225841	8/6/2011	6/29-7/3	Yes	X, Note1
...
20	1457865	8/13/2011	7/15	No	

Attributes:	A	Invoice total was properly approved.
	B	

Tickmark Legend:	✓	Attribute satisfied without exception.
	X	Attribute not satisfied.
	Note1	Partial service rendered prior to June 30.

Results:	One exception noted. Expenditure for partial services not accrued. The Controller has been notified of the error. See W/P MAP.2 for a copy of the exception.
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Case Study – Financial Risk Assessment

Agency ABC

Issue Summary Log

Prepared by:	J. Doe
Reviewed by (ICO and CFO):	T. Moore

**EAGLE Program
Issue Summary Log
Agency ABC
June 30, 2012**

Financial Statement Account(s)	Significant Process	Process Risk Rating	Control Description	Control Ref. #	Issue	Risk/ Implication	Recommendation	Management's Response
Accounts Payable	Determine manual AP accrual amount	Moderate	The JE voucher, spreadsheet, NCAS report and all supporting documents are given to the Controller who reviews the documentation and approves the voucher.	MAP3	A sample of 20 August expenditures was tested to determine if applicable amounts were properly accrued. An exception was noted for an invoice that included services that occurred both before and after June 30. Payment for the portion of services rendered prior to June 30 was not accrued. The amount in error totaled \$_____.	Understatement of accounts payable.	We recommend management emphasize the review of service dates during year-end accrual procedures.	We agree with the recommendation. Each year the accounting staff receives a memo regarding year-end procedures. We will emphasize the review of service dates.